FINANCIAL TIMES

Last updated: December 9, 2011 10:07 am

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Eurozone countries sign up to closer ties

By Peter Spiegel, Quentin Peel, Alex Barker and Stanley Pignal in Brussels

European leaders were struggling on Friday to cope with the consequences of a profound split over crisis plans for the eurozone, leaving the UK isolated and 23 member states of the European Union determined to press ahead with a new treaty to enforce tough changes to fiscal rules.

The refusal by David Cameron, UK prime minister, to agree to a full treaty change for all 27 EU members without inserting special safeguards for UK financial services caused a stand-off in the early hours with both Angela Merkel, German chancellor, and Nicolas Sarkozy, French president.

Despite the division – which will leave Britain out of the new pact, with the Czech Republic, Hungary and Sweden still weighing participation – Mario Draghi, the European Central Bank president, signalled his approval, a key vote of confidence that could allow the ECB to move more aggressively in eurozone bond markets.

"It's going to be the basis for a good fiscal compact and more discipline in economic policy in the euro area members," Mr Draghi said.

Markets reacted with unease to the deal, which the leaders said would enshrine new fiscal rules limiting debt and deficits and automatic penalties for countries that break them. The measures are designed to restore confidence after a two-year crisis that has stalled growth in the world's biggest economic bloc.

Ms Merkel sought to put a brave face on the outcome as she returned to the European Council this morning, saying the new treaty to be negotiated by the 17 eurozone members, plus at least six others, would lay the foundations for a "fiscal and stability union".

However, without agreement among all 27 countries, it remained unclear how the new fiscal rules the summit leaders promised to follow would be enforced. EU institutions – most importantly, the European Commission, which oversees and passes judgement on such rules in Brussels – legally cannot have a formal role in any agreement outside the EU treaties.

On Friday morning yields on Italian 10-year bonds, the barometer of investor uncertainty over the eurozone, rose by 16 basis points to 6.62 per cent following a surge on Wednesday, climbing back towards the 7 per cent level at which other countries in the single currency have found their debt payments unsustainable.

The euro weakened by 0.3 per cent against the dollar; the FTSE Eurofirst 300 opened with a drop of 0.8 per cent.

However, arriving for the crunch summit's second day, Angela Merkel, the German chancellor who had hoped to secure a deal with all 27 EU members, said: "We're very pleased with the result. Yesterday was no weak compromise for the euro."

The leaders said the new treaty would be signed by March.

José Manuel Barroso, the Commission president, said he believed there were ways to work around the deal's legal difficulties. But senior EU officials acknowledged it would be difficult to give Brussels new powers over eurozone national budgets outside the EU treaties, and diplomats expressed concern financial markets would not see the new pact as credible.

The UK that became the biggest stumbling block to a deal between all 27 countries, diplomats said, with David Cameron, prime minister, holding out for hours in the hope of getting concessions for the UK's financial services industry.

"Very simply, in order to accept the reform of the treaty at 27, David Cameron asked for what we thought was unacceptable: a protocol to exonerate the UK from financial services regulation," said Nicolas Sarkozy, the French president. "We could not accept this as at least part of the problems [Europe is facing] came from this sector."

Several diplomats said Mr Cameron emerged from Friday morning's negotiations deeply wounded, angering fellow EU leaders and getting no trade-offs for British interests.

"This is going to cost the UK dearly," said one senior EU official. "They have antagonised everyone."

Mr Cameron insisted that he had not ruptured relationships with his counterparts.

"I had to pursue very doggedly what was in British national interest," Mr Cameron said. "It is sometimes the right thing to say, 'I cannot do that, it is not in our national interest, I don't want to put that in front of my parliament because I don't think I can recommend it with a clear conscience, so I am going to say no and exercise my veto'."

Herman Van Rompuy, the European Council president, sought to highlight new short-term efforts agreed on Thursday night including €200bn in new EU funding for the International Monetary Fund, which will come from eurozone countries and some non-euro members, including the UK.

The cash is expected to go into a new IMF fund to help countries struggling to deal with the growing liquidity freeze.

EU leaders are expected to seek contributions from other countries outside Europe, and Christine Lagarde, the IMF managing director, said the money would be used to support the Fund's "global membership" – a key requirement for the UK, which does not want the aid specifically targeted to the eurozone. "These resources will enhance the IMF's capacity to fulfil its systemic responsibilities in support of its global membership," Ms Lagarde said in a statement.

But other short-term measures that Mr Van Rompuy had proposed ahead of the summit – including running two eurozone bail-out funds in tandem to increase EU rescue resources, and giving the eurozone's new €500bn rescue facility access to ECB funding – were either rejected or set aside for later debates.

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